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Kimberly J. Husted, Chapter 7 Trustee

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re:

ECS REFINING, INC.,

Debtor

Bank. Case No. 18-22453

Adversary No.

Chapter 7

KIMBERLY J. HUSTED,

Chapter 7 Trustee for ECS Refining, Inc.

Plaintiff,

vs.

WAL-MART STORES EAST, L.P.,

Defendant.

**COMPLAINT TO AVOID AND
RECOVER TRANSFERS PURSUANT TO
11 U.S.C. §§ 547, 548, 549 AND 550 AND
TO DISALLOW CLAIMS PURSUANT TO
11 U.S.C. § 502**

Plaintiff Kimberly J. Husted as Chapter 7 Trustee of ECS Refining, Inc. ("Trustee" or "Plaintiff")
hereby brings this action to avoid and recover transfers against Wal-Mart Stores East, L.P., ("Defendant")
and to disallow any claims held by Defendant.

1 **I. INTRODUCTION**

2 1. Plaintiff Kimberly J. Husted is the duly appointed Chapter 7 Trustee of the Estate of ECS
3 Refining, Inc. (“ECS” or “Debtor”).

4 2. Plaintiff seeks to avoid and recover from Defendant, or any other person or entity for
5 whose benefit the transfers were made, preferential transfers of property that occurred during the ninety
6 (90) day period prior to the commencement of the bankruptcy proceedings of ECS pursuant to sections
7 547 and 550 of the Bankruptcy Code.

8 3. Plaintiff also seeks to avoid and recover from Defendant or any other person or entity for
9 whose benefit transfers were made pursuant to sections 548 and 550 of the Bankruptcy Code any transfers
10 that may have been fraudulent conveyances.

11 4. Additionally, Plaintiff seeks to avoid and recover from Defendant or any other person or
12 entity for whose benefit transfers were made pursuant to sections 549 and 550 of the Bankruptcy Code
13 any transfers that were made after the Debtor commenced its bankruptcy case and which transfers were
14 not authorized by the Bankruptcy Code or this Court.

15 5. Plaintiff seeks to disallow, pursuant to section 502(d) of the Bankruptcy Code, any claim
16 that Defendant has filed or asserted against the Debtor or that has been scheduled for Defendant. Plaintiff
17 does not waive but hereby reserves all of her rights to object to any such claim for any reason, including,
18 but not limited to, any reason set forth in sections 502 of the Bankruptcy Code.

19 **II. THE PARTIES AND RELEVANT ENTITIES**

20 6. Debtor is a Delaware corporation, formerly engaged in the business of electronics
21 recycling. ECS’s corporate headquarters was located in Santa Clara, California and the Debtor’s largest
22 facility was located in Stockton, California.

23 7. By order of the Bankruptcy Court entered on September 28, 2018, Debtor’s Chapter 11
24 petition was converted to Chapter 7 liquidation effective October 2, 2018. Plaintiff is the Chapter 7
25 Trustee of the Debtor’s bankruptcy estate. Plaintiff has standing to file and prosecute the claims of the
26 Debtor asserted herein on behalf of the Debtor’s bankruptcy estate.

27 8. Upon information or belief, Defendant was, at all times relevant, a vendor or creditor to
28 or for the Debtor. Upon further information and belief, Defendant conducts business at 601 N. Walton

1 Blvd., Bentonville, AZ 72716.

2 **III. JURISDICTION AND VENUE**

3 9. This Court has subject matter jurisdiction over this adversary proceeding, which arises
4 under title 11, arises in, and relates to a case under title 11, in the United States Bankruptcy Court of the
5 Eastern District of California (“Court”), captioned *In re ECS Refining, Inc.*, Case No. 19-22453-RSB,
6 pursuant to 28 U.S.C. §§ 157 AND 1334(b).

7 10. The statutory and legal predicates for the relief sought herein are sections 502, 547, 548,
8 549 and 550 of the Bankruptcy Code and Rules 3007 and 7001 of the Federal Rules of Bankruptcy
9 Procedure.

10 11. This adversary proceeding is a “core” proceeding to be heard and determined by the Court
11 pursuant to 28 U.S.C. § 157(b)(2) and the Court may enter final orders for matters contained herein.

12 12. Venue is proper in the Eastern District of California pursuant to 28 U.S.C. § 1409.

13 13. Trustee consents to the entry of final orders or judgment by the Court.

14 **IV. FACTUAL BACKGROUND**

15 **A. ECS’s Business**

16 14. ECS was an electronics recycling company that was founded in 1980 by James Taggart
17 and Kenneth Taggart (“Taggarts”). It started as a processor of post-manufacturing scrap and residues for
18 original equipment manufacturers in Silicon Valley.

19 15. As the electronics industry grew, ECS shifted its focus to processing post-consumer
20 electronics as a vertically integrated electronics recycler. ECS provided recycling and asset disposition
21 services. ECS processed materials common in the electronics recycling industry such as industrial
22 equipment, networking and telecommunication devices, manufacturing waste residuals, and consumer e-
23 scrap peripherals. ECS was also well known to handle data sensitive hardware such as servers,
24 computers, laptops, and hard drives for major corporations and organizations. ECS typically made its
25 profits through its refurbishment and precious metal recovery of e-waste.

26 16. ECS had three primary sources of revenue: the SB 20 program, the end of life program,
27 and the AMS Program.

28 17. The SB 20 program, per California’s Covered Electronic Waste recycling specifications

1 under Titles 14 and 27 of the California Code of Regulations, allows certified recyclers to be paid for the
2 recycling of cathode ray tube (“CRT”) and non-CRT (flat panel) displays. If the reporting and processing
3 requirements were met, the California Department of Resources Recycling and Recovery paid ECS
4 within 90 days of a claim being submitted and was bound by state legislation to pay \$0.49/pound for
5 approved pounds.

6 18. The end of life program involved collection and recycling of electronic products that
7 required processing and recycling because of age, security, or disposal reasons.

8 19. Through the AMS program, ECS sold refurbished electronics to various customers. It
9 also sold arranged items based on contract or statement of work. Material prices and fees were agreed
10 upon by both parties and were set as either fair market value (“FMV”) or revenue-share agreements. With
11 FMV contracts, AMS purchased material at FMV and recognized service and destruction revenue when
12 the service was performed. With revenue share agreements, AMS did not earn revenue until the material
13 was refurbished and resold.

14 **B. SummitBridge Loans**

15 20. In February 2012, Bank of America, N.A. (“Bank of America”) made a revolving loan to
16 ECS in the maximum principal commitment amount of \$15,000,000 and a term loan in the maximum
17 principal commitment amount of \$35,000,00.

18 21. Bank of America and ECS entered into that certain Credit Agreement dated as of February
19 6, 2012, and which was further amended on or about April 30, 2013, January 29, 2014, and April 24,
20 2015. ECS executed that certain Revolving Note in the maximum principal commitment amount of
21 \$15,000,000 dated as of February 6, 2012, in favor of Bank of America and that certain Acquisition Term
22 Note in the maximum principal commitment amount of \$35,000,000, dated as of February 6, 2012, in
23 favor of Bank of America.

24 22. Bank of America’s loans were secured by ECS’s property including equipment, inventory,
25 goods, work in progress and fixtures, by way of, among others: Security Agreement dated as of February
26 6, 2012; Trademark Security Agreement dated as of February 6, 2012; Patent Security Agreement dated
27 as of May 22, 2015; and Pledge Agreement dated as of February 6, 2012.

28 23. In approximately March 2017, Bank of America sold, assigned and conveyed the loans

1 and corresponding loan documents to SummitBridge National Investments V LLC (“SummitBridge”).
2 The loans assigned to SummitBridge are collectively referred to as the SummitBridge Loans.

3 24. On or about June 21, 2017, ECS entered into a Forbearance Agreement with
4 SummitBridge, wherein ECS acknowledged events of default under the SummitBridge Loans. ECS also
5 acknowledged that as of May 15, 2017, it owed SummitBridge the amount of \$5,672,658 on account of
6 the revolving loan and the amount of \$19,898,446 on account of the term loan. SummitBridge agreed to
7 forbear from exercising its rights through December 31, 2017.

8 **C. ECS insolvency**

9 25. In or around August 2017, ECS obtained a debt restructuring analysis which indicated that
10 ECS’s liabilities were \$43 million and its assets \$32 million. Its debts exceeded its assets.

11 26. Starting on or around October 2017, given the balance owed on SummitBridge’s Loans,
12 ECS through its professionals appear to have attempted to negotiate with SummitBridge.

13 27. By the beginning of December 2017, in addition to the debt that had come due to
14 SummitBridge, ECS owed two of its largest suppliers nearly three million dollars.

15 28. SummitBridge was willing to provide ECS with funds, however, it requested additional
16 equity in the Debtor in return. The Taggarts were not willing to invest their own money into the company,
17 nor were they willing to give up control of the Debtor. On December 6, 2017, ECS informed
18 SummitBridge that the “current shareholders are not interested in investing unless they have control [of
19 the Debtor] and 40% each.”

20 29. It was internally decided that ECS would not send information to SummitBridge that the
21 lender could use “for an emergency Receivership or something [they did not] want.”

22 30. While ECS’s owners placated SummitBridge with potential settlement terms from
23 December 2017 up until days before the bankruptcy filing, ECS’s owners and professionals were
24 developing ways to file bankruptcy and minimize ECS’s assets that were secured by SummitBridge’s
25 Loans in order to “take out SummitBridge” and gain control of the company.

26 31. On or about April 19, 2018, as SummitBridge and ECS appeared to be at an impasse,
27 SummitBridge circulated a proposed order appointing a receiver to take control of ECS through a
28 receivership process.

32. On April 24, 2018, ECS filed its Chapter 11 petition. Per the Emergency *Ex Parte* Motion for Order (1) Authorizing Debtor to Obtain Post-Petition Financing Pursuant to 11 U.S.C. §364; (2) Granting Liens and Super Priority Claims Pursuant to §364; (3) Authorizing the Use of Post-Petition Cash Collateral Pursuant to 11 U.S.C. §363; (4) Scheduling a Final Hearing; and (5) Granting Related Relief (“DIP Loan Motion”), ECS painted the picture of the Debtor’s poor financial condition.

33. In the DIP Loan Motion, ECS noted that the Debtor’s total liabilities were \$32,888,318.41 of which \$25,927,581.91 was secured debt and approximately \$6,960,736.50 was unsecured debt.

34. The DIP Loan Motion also stated that the Debtor’s assets consisted of: machinery and equipment with a gross liquidation value of \$3.0 to \$4.5 million; intellectual property valued at approximately \$19,720.92; \$9,838,316.99, at book value, of property and equipment; \$811,638.75, at book value of physical inventory; (iv) \$7,129,561.34 at book value in receivables, pre-paid expenses, and other assets; and \$0 in cash. Debtor’s liabilities exceeded its assets.

35. The Debtor’s schedules indicate that at the time of filing, the Debtor’s assets totaled \$7,364,882.00 and liabilities totaled \$32,568,307.

D. Cash consumption

36. Prior to the Petition Date, the Debtor as a recycling company maintained business relationships with various business entities, through which the Debtor purchased, received, sold and/or delivered goods and services.

37. During the ninety days before the Petition Date, that is between January 24, 2018 and April 24, 2018 (“Preference Period”), the Debtor transferred property either by checks, wire or ACH transfers, direct deposits or otherwise to various entities. The Debtor drew upon its accounts to pay vendors, suppliers, and other creditors.

38. Upon information and belief, during the course of the business relationship, Defendant and the Debtor entered into agreements, evidenced by invoices, communications or other documents that concerned or related to goods and/or services provided.

39. Defendant conducted business with the Debtor through and including the Petition Date. Debtor purchased and/or received goods and/or services from Defendant or otherwise held a debt owned by Debtor.

1 40. Plaintiff has determined that Debtor made transfer(s) of an interest of the Debtor's
2 property to or for the benefit of Defendant during the Preference Period ("Transfer" or "Transfers"). The
3 details of each Transfer are set forth on Exhibit A attached hereto and incorporated by reference.

4 41. During the Preference Period, ECS deliberately chose to consume virtually all of its
5 existing cash by making payments to vendors and/or creditors, including Defendant. Ninety days prior
6 to the Debtor's bankruptcy, ECS made outgoing payments that exceeded \$18.7 million.

7 42. Cash consumption was irregularly high. On the morning of the Petition Date, James
8 Taggart forwarded an email notification from Wells Fargo to Kenneth Taggart which stated that "Your
9 Wells Fargo Business account has reached zero dollars."

10 43. ECS through its professionals and insiders sought to create a cash shortage leading up to
11 the Debtor's bankruptcy so that the Debtor would need cash on an urgent basis which would be funded
12 by the Debtor's insiders – the Taggarts – on a super-priority basis and to the Debtor and SummitBridge's
13 detriment.

14 **E. Inventory Segregation**

15 44. Coupled with the accelerated spending, the Debtor deliberately suspended processing
16 inventory that was secured by SummitBridge's Loans.

17 45. Despite having its full workforce employed, employees were instructed to segregate pre-
18 petition inventory that was secured by SummitBridge's Loans and stop accepting new inventory to be
19 processed.

20 46. ECS made the decision to intentionally operate at less than full capacity, despite the fact
21 that processing the raw goods inventory would have created accounts receivable and needed liquidity.

22 47. The company's net accounts receivables show a considerable decline in funds leading up
23 to the bankruptcy:

- 24 a. \$8.49 Million in January 2018;
25 b. \$6.26 Million in February 2018;
26 c. \$6.13 Million in March 2018; and
27 d. \$4.02 Million in April 2018.

28 48. ECS's inventory plummeted from \$2.52 million in March 2018 to approximately

1 \$350,000 in April 2018. Further, its net income loss went from (\$1.56 million) in March 2018 down to
2 (\$4.4 million) in April 2018.

3 49. As a direct result of the Debtor's rapid cash consumption and the decision to stop
4 accepting and processing inventory, available cash for operations and account receivables were
5 drastically reduced thereby making it impossible for the Debtor to operate solely on cash collateral and
6 requiring a Debtor-in-Possession loan.

7 **F. The insider DIP loan**

8 49. On April 16, 2018, Jim Taggart wrote to an individual who knew of "a potential interested
9 party in doing some DIP lending to ECS when [it was to] file for reorganization." That same day, the
10 referring individual emailed the potential interested lender with Jim Taggart copied and said, in part,
11 "The impetus for the capital raise of \$6 million + is a 'take out' of a private equity firm who purchased
12 the underlying ECS debt from a bank. The funds is slated for a total take out of the current private equity
13 firm."

14 50. In the DIP Loan Motion, the Debtor sought to obtain a \$6.0 million loan from Butch and
15 Sundance LLC ("BS"). As stated by James Taggart in his declaration in support of the reply to the
16 opposition to the motion to dismiss the bankruptcy case, BS was formed by ECS's counsel eight days
17 prior to the bankruptcy case. The Taggarts were the only members and managers of BS.

18 51. The Debtor and its bankruptcy counsel did not disclose to the Court that the DIP Loan
19 was funded by the Debtor's insiders – the Taggarts. The DIP Loan Motion also concealed the fact that
20 Debtor's largest landlords (Sinclair Partners, LLC and ECS Big Town, LLC), who were to be paid
21 approximately \$140,000 per month from the proceeds of the DIP Loan, were also owned and effectively
22 managed by the Taggarts.

23 52. The Debtor and its bankruptcy counsel misrepresented to the court in the DIP Loan Motion
24 that the "DIP Loan has been negotiated in good faith and at arm's length by the Debtor and the Lender"
25 when in reality the Debtor's insiders were on both sides of the transaction. Despite the fact that post-
26 petition financing from insiders is subject to heightened scrutiny and examination, ECS and its counsel
27 did not inform the court of the true nature of the financing transaction.

28 53. The terms of the DIP Loan were neither fair nor reasonable to the Debtor or the estate.

1 The amounts and obligations owed to BS had priority over any and all administrative expenses and all
2 other claims against the Debtor. No proceeds from the DIP Loan could be used by the Debtor, any
3 committee, or any trustee or estate representative to investigate, assert, or prosecute any claims against
4 BS, and its “officers, directors, employees, agents, attorneys, affiliates, assigns or successors” including
5 any actions arising under Chapter 5 of the Bankruptcy Code. This provision effectively prohibited the
6 Debtor from investigating any claims against the Taggarts.

7 54. On May 1, 2018, after the Court was informed of the true nature of the DIP Loan, the
8 Bankruptcy Court stated that it was “troubling” and “striking” that BS was created a week before the
9 Petition Date and that it was owned by the Debtor’s principals and shareholders.

10 55. The DIP Loan Motion confirmed the financial condition of the Debtor and strategic and
11 substantial harm that was brought on to ECS. The motion provides: “accounts receivable are not
12 consistent enough to provide cash flow necessary for operations on a daily basis.” Additionally, “There
13 is no dispute that, without substantial post-petition financing, the Debtor will be forced to immediately
14 cease business operations and engage in a fire sale of its assets...” Further, the “Debtor would have very
15 little chance of avoiding an immediate shutdown of its business if not for the DIP Loan.”

16 **G. The Conversion to Chapter 7**

17 56. Given the Court’s concern over the lack of disclosures and handling of the case, on May
18 8, 2018, a Chapter 11 Trustee was appointed.

19 57. By October 2, 2018, the bankruptcy case was converted to a Chapter 7 under the
20 Bankruptcy Code. The Court found that conversion to Chapter 7 was in the best interests of the creditors
21 and the estate.

22 **CLAIMS FOR RELIEF**

23 **COUNT 1:**

24 **(Avoidance of Preference Period Transfers – 11 U.S.C. § 547)**

25 58. Plaintiff re-alleges and fully incorporates the allegations pleaded above as if fully set forth
26 herein.

27 59. As more particularly described on Exhibit A attached hereto and incorporated herein,
28 during the Preference Period, the Debtor made Transfers to or for the benefit of Defendant.

C. The Debtor intended to incur, or believed it would incur, debts beyond its ability to pay upon maturity.

71. Based upon the foregoing, the each Potentially Fraudulent Transfer is avoidable pursuant to 11 U.S.C. § 548(a)(1)(B).

(Avoidance of Unauthorized Post-Petition Transfers – 11 U.S.C. § 549)

72. Plaintiff re-alleges and fully incorporates the allegations pleaded above as if fully set forth herein.

73. To the extent any of the Transfer(s) identified on Exhibit A cleared the Debtor's accounts after the Petition Date, and such Transfer(s) were not authorized by the Court or the Bankruptcy Code ("Post-Petition Transfers"), Plaintiff pleads in the alternative that such post-petition transfers are avoidable pursuant to 11 U.S.C. § 549.

(Recovery of Avoided Transfers – 11 U.S.C. § 550)

74. Plaintiff re-alleges and fully incorporates the allegations pleaded above as if fully set forth herein.

75. Plaintiff is entitled to avoid each Transfer pursuant to 11 U.S.C. §§ 547, any Potentially Fraudulent Transfer pursuant to 11 U.S.C. § 548, and/or any Post-Petition Transfers pursuant to 11 U.S.C. § 549 (collectively, the “Avoidable Transfers”).

76. Defendant was the initial transferee of the Avoidable Transfers or the immediate or mediate transferee of such initial transferee or the person for whose benefit the Avoidable Transfers were

1 made.

2 77. Pursuant to 11 U.S.C. § 550(a), Plaintiff is entitled to recover from Defendant the
3 Avoidable Transfers, plus interest thereon to the date of payment and the costs of this action.

4 **COUNT 5**

5 **(Disallowance of all Claims – 11 U.S.C. § 502(d))**

6 78. Plaintiff re-alleges and fully incorporates the allegations pleaded above as if fully set forth
7 herein.

8 79. Defendant is a transferee of transfers avoidable under sections 547, 548, and/or 549 of the
9 Bankruptcy Code, which property is recoverable under section 550 of the Bankruptcy Code.

10 80. Defendant has not paid the amount of the Avoidable Transfers, or turned over such
11 property, for which Defendant is liable under 11 U.S.C. § 550.

12 81. Pursuant to 11 U.S.C. § 502(d), any and all claims of Defendant and/or its assignee,
13 against the Debtor's estate must be disallowed until such time as Defendant pays to Plaintiff an amount
14 equal to the aggregate amount of the Avoidable Transfer, plus interest thereon and costs.

15
16 WHEREFORE, Plaintiff prays for entry of judgment against the Defendant on the above claims
17 for relief as follows:

18 A. On Plaintiff's First, Second, Third, and Fourth claims for relief, judgment in favor of
19 Plaintiff and against Defendant avoiding all of the Avoidable Transfers and directing Defendant to return
20 to Plaintiff the amount of the Avoidable Transfers, pursuant to 11 U.S.C. §§ 547, 548, and/or 549 and
21 550, plus interest from the date of demand at the maximum legal rate and to the fullest extent allowed by
22 applicable law, together with the costs and expenses of this action including without limitation attorneys'
23 fees;

24 B. On Plaintiff's Fifth Claim for Relief, judgment in favor of Plaintiff and against Defendant
25 disallowing any claims held or filed by Defendant until Defendant returns the Avoidable Transfers
26 pursuant to 11 U.S.C. § 502(d);

27 ///

28 ///

C. For such other and further relief as the Court may deem just and proper.

Dated: April 23, 2020

DIAMOND MCCARTHY LLP

By:

/s/Christopher D. Sullivan

CHRISTOPHER D. SULLIVAN

Special Litigation Counsel for Plaintiff Kimberly J.
Husted, Chapter 7 Trustee